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OFFICE OF COMPTROLLER
DEPARTMENT OF BANKING AND FINANCE
STATE OF FLORIDA
TALLAHASSEE
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COMPTROLLER OF FLORIDA

April 7, 1999

Mr. Donald V. Hammond
Fiscal Assistant Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Room 2112
Washington, D. C. 20220

Dear Mr. Hammond:

The Florida Department of Banking and Finance appreciates the opportunity to submit comments on the Treasury Department's Advance Notice of Proposed Rulemaking regarding access to accounts at financial institutions through payment service providers, published in the Federal Register on January 8, 1999.

Our detailed comments are attached.

We look forward to continuing to work with you as the federal electronic benefit transfer initiative continues.

Sincerely,

Robert F. Milligan
Comptroller

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Attachment

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Florida Department of Banking and Finance's
Comments on the Treasury Department's Advance
Notice of Proposed Rulemaking as published in 1/8/99 "ANPRM"

The advance notice of proposed rulemaking ("ANPRM") published in the *Federal Register* on January 8, 1999 noted that, prior to the establishment of the Treasury electronic transfer (ETA) accounts later this year, certain financial institutions have entered into arrangements with nondepository payment service providers, such as check cashers, currency dealers and exchangers, and money transmitters. Through these arrangements, recipients of electronic federal payments deposited into a non-ETA account may gain access to benefit payments through a payment service provider, as opposed to directly through the financial institution.

As the regulator of state-chartered financial institutions and payment service providers in Florida the Department has closely followed the advent of Federal electronic benefit transfers and the evolving relationship between these industries.

Financial institutions should, if possible, be prohibited from entering into relationships with payment service providers.

Based on our review of the federal electronic benefit services currently being offered through payment service providers, we recommend that Treasury prohibit financial institutions from entering into relationships with providers that would allow federal electronic benefit recipients to receive benefits through the provider.

We are aware that several of the existing products are being offered through providers and financial institutions with outstanding reputations. However, allowing electronic federal benefits to be offered through a broader set of service providers is, in our view, ultimately harmful to the consumer and frustrates the goal of getting these consumers into the banking system.

In the event that Treasury does not prohibit federal electronic benefit transfer recipients from receiving benefits through payment service providers, the Department recommends the following:

Treasury should prohibit any advances on anticipated Federal EFT benefit payments.

Over the last several years, the Department has had a great deal of experience with the rapidly expanding payday loan industry. The Florida Legislature is currently reviewing a bill that would raise these industries allowable rates in Florida from 10% to 15%. We are opposing this industry initiative. We are also opposed to any initiative to expand the reaches of this industry to those currently without bank accounts.

The existing payday loan industry serves banking account customers who have

short-term needs for cash and cannot or choose not to use less costly alternatives. In the typical transaction in Florida, an individual writes the payment service provider a check, which the provider agrees to hold for 14 days. The provider charges a 10% flat fee for this service. At the end of the 14 day period, the customer either repurchases the check with cash or simply allows the check to be placed into the payment system. In the alternative, if the customer does not have the money in his/her account to pay for the check, Florida law does not allow the service provider to "roll over" the transaction. As a practical matter, many of these transactions are rolled over illegally, with the customer continually paying the 10% fee in order to keep the check from entering the payment system and being returned for insufficient funds.

The Department is concerned that payment service providers currently offering payday loans to those with bank accounts will increasingly offer a similar product to federal benefit recipients. This would allow the recipient to receive a portion of his/her benefit early for a fee. Receiving federal benefits electronically through a service provider already costs the recipient more than having an ETA account or continuing to receive a check. The additional fees that must paid for getting an early benefit can greatly reduce the monthly benefit ultimately received.

The payday loan industry currently calls its product "deferred presentment". An appropriate term for the expansion of the deferred presentment product into the federal benefit market would be "expedited withdrawal". For example: in an expedited withdrawal service already available in Florida, a benefit customer can overdraw his/her account by $30 for an additional $19.95 fee. The overdraft protection, whether used or not, costs the customer $7 a month. In fact, the customer, when contracting with the service provider, does not have the option of <u>not</u> getting the overdraft protection.

The fees associated with this service bear no relationship to the providers risk. For example, the same service provider may offer a deferred presentment product at a 260% annual percentage rate, yet charge a 650% APR for the expedited withdrawal of a federal benefit. The cost of this withdrawal to the customer is <u>unconscionable</u>. The early withdrawal of a federal benefit carries less risk than a typical deferred presentment transaction, in that the provider is guaranteed to receive his repayment at the time of the customer's next benefit transfer.

<u>Financial institutions should be responsible for adequate disclosures.</u>

Treasury has stressed that financial institutions in arrangements with third-party providers should provide appropriate disclosures to customers as to fees imposed by all parties to the arrangement, the legal relationships involved, and the applicability of federal deposit insurance.

In the ANPRM, Treasury has also asked for comments as to whether enhanced disclosure requirements should be imposed on financial institutions regarding products offered to federal benefit recipients through service providers. While most institutions and providers provide appropriate disclosures, the Department has found other instances where such disclosures were not adequate or timely. In one instance, customer disclosures reviewed by the Department were constructed in a manner making it difficult to determine into which financial institution the customer's benefit would be deposited. In at least one instance, the customer's rights under Regulation E of the Federal Reserve Board and/or the applicability of Federal deposit insurance were not explained. The timeliness with which the recipient receives the disclosures is also an issue. For instance, simple, one- page, sign-up sheets are utilized by the service provider to initiate the service. The recipient does not receive information regarding fees and consumer protection after he signs up.

The Department agrees with Treasury that the financial institution in which the recipient's benefit is ultimately deposited bears some responsibility to ensure that proper disclosures are made at the time he/she signs up for the service. At the same time, in many instances it is not the financial institution or the service provider, but rather a third party, that is responsible for marketing and servicing the federal electronic benefit relationship. Generally, the financial institution is completely insulated from the consumer complaint resolution process. Since no regulatory state or federal level regulatory nexus exists regarding these third parties, it is vital that financial institutions offering these bank accounts through payment service providers be held accountable for adequate, understandable and timely disclosure of all fees and consumer protections associated with federal electronic benefit services offered through payment service providers. Such disclosures should contain the name, address, and phone number of the financial institution. This would assure the recipient of a point of contact, should he/she fail to have a complaint satisfactorily resolved by either the payment service provider or the third party servicer.

Benefit recipients should have uninterrupted access to their funds in the event a service provider ceases operation.

Certain payment service providers offering federal electronic benefit services do not issue a debit card, but require benefit recipients to come to the provider to receive a benefit check. In these instances, the recipient must notify the financial institution in writing if he/she desires to change the payment service issuer where the check is physically received.

The Department is aware that the existing payment service providers dealing with federal electronic benefits in this fashion have done so successfully, with few if any consumer complaints. As the practice of providing electronic benefits by check through

payment service providers grows, however, the Department is concerned that instances may arise where recipients could have their benefit stream interrupted for several months, due to the failure or closure of the payment service provider.

As a result, Treasury should make every effort to ensure that the process by which federal benefit recipients can either change payment service providers or receive a check directly from Treasury does not interrupt the benefit stream.

Benefits provided through check-based electronic benefit systems should be covered by state permissible investment, bonding, and net worth requirements.

In the January 8, 1999 ANPRM, Treasury expressed concern that a common characteristic of payment service providers is that they are not subject to comprehensive federal regulation and are generally subject only to limited regulation, if any, at the state level.

The portion of the payment service provider industry most actively involved in the payment of federal electronic benefits is, of course, the check cashing industry. Portions of this industry have, in turn, historically depended on the cashing of federal benefit checks for a significant percentage of their business.

States are becoming increasing active in the regulation of the check cashing industry. At least twenty-seven states currently regulate the industry. Florida instituted a registration requirement and fee caps for check cashers in 1994, and at the same time, established a registration requirement for all other money services businesses as defined by Treasury's Financial Crimes Enforcement Network.

Thus, state regulation of this industry is evolving as check cashers themselves evolve. In our view, the next phase of this evolution should apply in certain instances, to check cashers, state permissible investment, bonding, and net worth requirements. Up to this point, such requirements have generally only applied to issuers of payment instruments and remitters of funds either domestically or abroad.

In the check-based federal electronic benefit systems offered through payment service providers, the check casher has entered into a fiduciary relationship with the benefit recipient and has access to the recipient's benefit when it is housed within the trust or pooled bank account in the check casher's name. The check issued by the check casher is payable through the check cashers account. For these reasons, it is the Department's opinion that check casher's offering check-based delivery of federal electronic benefits are acting as payment instrument issuers.

At least forty-three states regulate the issuance of payment instruments, so the regulation of this portion of the money services business industry is much more pervasive at the state level than the regulation of check cashers. State law in this area generally requires that any outstanding payment instrument (which in our view would include outstanding federal benefit payments) be covered by permissible investments on the part of the issuer. In Florida's case, permissible investments backing up any outstanding payment instruments include cash, certificates of deposit, government obligations, shares in a money market fund, or an investment bearing a rating of one of the three highest grades as defined by a nationally recognized rating service.

Benefits not covered by federal deposit insurance should be covered by state permissible investment and bonding statutes.

In a debit card-based system currently offered through payment service, the federal benefits that initially are electronically transmitted to an individual recipient's account are "swept" into an uninsured account of the payment service provider. In the case of payment service providers pooling benefit recipient funds in uninsured accounts, it is vital that such providers be licensed by the states and subject to state permissible investment and bonding statutes.

The states have had a long history of regulating payment instrument issuers and remitters. For instance, Florida, along with most states, has regulated payment instrument issuers since 1965.

State permissible investment statutes essentially perform as a hundred percent reserve requirement. Florida law requires that payment instrument issuers and remitters of funds domestically and aboard have permissible investments equal to their outstanding transmittal liabilities and also have a bond in place which shall run to the benefit of any claimants against the issuer or remitter. Thus, to the extent that Treasury allows the pooling of federal recipient benefits into uninsured accounts, such accounts should be treated for the purposes of state law as containing payment instrument liabilities subject to state law.

Benefits provided through debit card-based electronic benefit systems may be violating state laws regarding interstate branching and/or deposit taking and thus should be prohibited.

To the extent, in a debit card-based system, such accounts are not treated for the purposes of state law as containing payment instrument liabilities subject to state law, such accounts are depository in nature and therefore may be violating state laws regarding interstate branching and/or deposit taking.

A current debit card system offered in Florida allows the federal benefit recipient to make deposits into his account through either a "manned ATM" at the payment service provider or through certain ATMs in Florida. These deposits are made into an out-of-state bank.

In Florida, a manned ATM is considered a branch. It is, therefore, illegal for a bank not authorized to do business in our state to allow withdrawals or deposits by customers into a Florida-based manned ATM. Such a practice constitutes illegal branching under Florida's interstate banking and branching law. It is also a violation of Florida law for such banks to take deposits at an unmanned ATM. Such practices facilitated by existing relationships between payment service providers and financial institutions are in violation of state law and should be prohibited.